

Italy

Italian Financial Transaction Tax Implications of the Evolving Regulatory Landscape: The Exemption for Market Makers – An Update

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Issue: Finance and Capital Markets (formerly Derivatives & Financial Instruments), 2020 (Volume 22), No. 2

Published online: 7 July 2020

This article outlines the interrelations between the exemption for market-making activities under the Short Selling Regulation, as interpreted by the European Securities and Markets Authority (the ESMA), and the Italian financial transaction tax exemption available for market makers. The author considers in this respect the implications deriving from the November 2019 joint communication by CONSOB^[1] and the Bank of Italy concerning the ESMA Guidelines, the United Kingdom's exit from the European Union on 31 January 2020 and the three-month short selling restriction enacted by CONSOB in March 2020.

1. Introduction

The Italian financial transaction tax (the IFTT) was enacted by article 1, paragraphs 491-500 of Law 228 of 24 December 2012 (*Legge di Stabilità 2013*, the Stability Bill), published in Official Gazette 302 of 29 December 2012. The provisions of the Stability Bill only set out the main framework for the IFTT. The detailed operational rules are contained in the Decree enacted on 21 February 2013 by the Ministry of Economy and Finance (the Treasury Decree), as subsequently amended and restated.^{[2][3]}

The IFTT provisions rely in some circumstances on regulatory concepts and cross-reference for these purposes other pieces of legislation, such as Regulation (EU) No. 236/2012 of the European Parliament and of the Council of 14 March 2012 (the Short Selling Regulation),^[4] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 (MiFID I)^[5] and Commission Regulation 1287/2006 of 10 August 2016 (MiFID I Implementing Regulation).^{[6][7]}

This is, in particular, the case of the IFTT exemption for market makers.^[8] Indeed, market-making activities, as defined in article 2(1)(k) of the Short Selling Regulation and in the ESMA Guidelines on the exemption for market-making activities and primary market operations under Regulation (EU) No. 236/2012 on short selling and certain aspects of credit default swaps (the ESMA Guidelines),^[9] are exempt from IFTT (the IFTT MM exemption).^{[10][11]}

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1. Commissione Nazionale per le Società e la Borsa – Autorità italiana per la vigilanza dei mercati finanziari.
2. The Treasury Decree was slightly amended on 18 Mar. 2013. Further significant amendments were introduced by way of Decree of 16 Sept. 2013.
3. For a comprehensive overview of the IFTT rules, see R-A. Papotti & M. Gusmeroli, *Italian FTT in Practice: Issues and Solutions*, 19 Derivs. & Fin. Instrumts. 4 (2017), Journals IBFD; V. Salvadori di Wiesenhoff, *Update on Financial Transaction Tax*, 15 Derivs. & Fin. Instrumts. 6 (2013), Journals IBFD; and V. Salvadori di Wiesenhoff & R. Egori, *2013 Italian Financial Transaction Tax*, 15 Derivs. & Fin. Instrumts. 2 (2013), Journals IBFD.
4. Regulation (EU) No. 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps [hereinafter Short Selling Regulation].
5. Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.
6. Commission Regulation 1287/2006 of 10 August 2016 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards recordkeeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive.
7. MiFID I and the MiFID I Implementing Regulation, however, are no longer in force, having been replaced by the MiFID II legislative package, which consists of MiFID II (Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173/349 [hereinafter MiFID II]) and the MiFIR (Regulation (EU) No. 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No. 648/2012, OJ L 173 [hereinafter MiFIR]) together with delegated acts and technical standards. As a consequence, where the IFTT rules rely on MiFID I provisions, these should be replaced with the corresponding MiFID II/MiFIR rules.
8. See art. 16(3)(a) Treasury Decree.
9. ESMA/2013/74, published on 2 Apr. 2013, available at <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-74.pdf> (accessed 8 June 2020).
10. See in this respect sec. 3.
11. For a comprehensive review of the Short Selling Regulation and the IFTT MM exemption, see V. Salvadori di Wiesenhoff, *Brexit: Deal or No Deal? Regulatory and Tax Implications for the Banking and Financial Services Industry – Part II*, 21 Derivs. & Fin. Instrumts. 6, sec. 4.3.3 (2019), Journals IBFD; V.

The Short Selling Regulation requires market participants to provide information on significant net short positions in shares and poses restrictions on uncovered short selling of shares. Under article 17 of the regulation, however, the information requirements and the restrictions do not apply to transactions performed in the course of market-making activities, as defined in article 2(1) (k) of the Short Selling Regulation.^[12]

The IFTT MM exemption is linked to the definition of market-making activities in the Short Selling Regulation and to the interpretation adopted in the ESMA Guidelines on how the market-making exemption in the Short Selling Regulation should be applied.

The national competent authorities (NCAs) of eight EU Member States, however, are not following in full the ESMA Guidelines, for various reasons. Some of them are disagreeing on the narrow interpretation adopted by the ESMA on certain topics (the disagreeing NCAs). Others, on the contrary, agree with the content of the ESMA Guidelines, but disapply some of these provisions to avoid an unlevel playing field between investment firms established in different EU Member States (the disapplying NCAs). As a consequence, the market-making exemption under the Short Selling Regulation is not applied in a consistent manner across the European Union and this may have significant implications on the IFTT MM exemption as well.

2. The Short Selling Regulation

2.1. General

The Short Selling Regulation^[13] requires information on significant net short positions in shares to be notified to the competent authorities or disclosed to the market and imposes restrictions on naked short selling in shares.^[14]

In particular, market participants, whether domiciled or established within the European Union or in a third country,^[15] are required to privately report to the relevant competent authority or disclose to the public significant net short positions^[16] which they hold in relation to the issued share capital of a company whose shares are admitted to trading or traded on a trading venue (regulated market or multilateral trading facility) in the European Economic Area (EEA) (unless they are primarily traded on a third-country venue),^[17] when the position equals, exceeds or crosses downwards specified thresholds.^[18] On 17 March 2020, the ESMA

Salvadori di Wiesenhoff, *Italian Financial Transaction Tax Implications of the Evolving Regulatory Landscape: The Exemption for Market Makers*, 20 *Derivs. & Fin. Instrum.* 1 (2018), *Journals IBFD*.

12. See in this respect sec. 2.

13. The short selling framework is made up of the following EU legislation: (i) the Short Selling Regulation; (ii) Commission Delegated Regulation (EU) No. 826/2012 of 29 June 2012 supplementing the Short Selling Regulation with regard to regulatory technical standards on notification and disclosure requirements with regard to net short positions, the details of the information to be provided to the ESMA in relation to net short positions and the method for calculating turnover to determine exempted shares, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32012R0826> (accessed 8 June 2020); (iii) Commission implementing Regulation (EU) No. 827/2012 of 29 June 2012 laying down implementing technical standards with regard to the means for public disclosure of net position in shares, the format of the information to be provided to the ESMA in relation to net short positions, the types of agreements, arrangements and measures to adequately ensure that shares or sovereign debt instruments are available for settlement and the dates and period for the determination of the principal venue for a share according to the Short Selling Regulation, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32012R0827> (accessed 8 June 2020); (iv) Commission Delegated Regulation (EU) No. 918/2012 of 5 July 2012 supplementing the Short Selling Regulation with regard to definitions, the calculation of net short positions, covered sovereign credit default swaps, notification thresholds, liquidity thresholds for suspending restrictions, significant falls in the value of financial instruments and adverse events, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32012R0918> (accessed 8 June 2020); and (v) Commission Delegated Regulation (EU) No. 919/2012 of 5 July 2012 supplementing the Short Selling Regulation with regard to regulatory technical standards for the method of calculation of the fall in value for liquid shares and other financial instruments, available at <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32012R0919> (accessed 8 June 2020).

14. Similar requirements and restrictions also apply in respect of short sales of sovereign debt instruments.

15. Art. 10 Short Selling Regulation.

16. For the purposes of the Short Selling Regulation, short positions are those obtained through a short sale of a share or through entering into a transaction the effect of which is to confer a financial advantage on the position holder in the event of a decrease in the price or value of the share. In calculating net short positions, derivative positions in a share shall be "delta adjusted" (i.e. persons taking positions through derivatives need to adjust the nominal/notional value of these positions by the relevant "delta" in order to calculate net short positions in the underlying). Positions held through baskets and indices need also to be taken into account.

17. Based on art. 16 Short Selling Regulation, the requirements concerning the notification and disclosure of significant net short positions in shares and the restrictions on uncovered short sales in shares do not apply in respect of shares that are admitted to trading or are traded in the EEA where the principal trading venue is in a third country. The competent authorities are required to identify the shares having their principal trading venue located in a third country and shall notify the ESMA of such shares at least every two years. On the basis of these notifications, the ESMA publishes the compiled list of exempted shares to which provisions of the Short Selling Regulation relating to net short position transparency and the restriction of uncovered short sales do not apply. Such a list is available at https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_mifid_shsexs (accessed 8 June 2020).

18. Based on art. 5 Short Selling Regulation, a holder of a net short position in relation to the issued share capital of a company shall notify the relevant competent authority when the position reaches or falls below 0.2% of the issued share capital of the company concerned and each 0.1% above that. Therefore, the holder of the net short position is required to make an initial private notification to the relevant competent authority when the position reaches 0.2% of the capital and to make subsequent disclosures for each incremental 0.1% threshold crossed (upwards or downwards) above 0.2%. A final notification is required once the position has fallen below 0.2%. Based on art. 6 Short Selling Regulation, a holder of a net short position in relation to the issued share capital of a company shall disclose details of that position to the public when the position reaches or falls below 0.5% of the issued share capital of the company concerned and each 0.1% above that. Therefore, the holder of the net short position is required to make an initial public disclosure when the position reaches 0.5% of the capital and to make subsequent disclosures for each incremental 0.1% threshold crossed (upwards or downwards) above 0.5%. A final disclosure is required once the position has fallen below 0.5%.

adopted a decision that temporarily lowers the notification thresholds of net short positions.^[19] The ESMA renewed its decision on 10 June 2020, for an additional three-month period.^[20]

In addition, the Short Selling Regulation acknowledges that uncovered short selling may increase the potential risk of settlement failure and volatility and, as a consequence, imposes restrictions in that respect to reduce such risks, stating that a short sale of a share can be entered into only where certain conditions have been met.^[21]

However, under article 17 of the Short Selling Regulation, the requirements concerning notification or disclosure of significant net short positions in shares and the restrictions on uncovered short sales in shares do not apply when these transactions are performed in the course of market-making activities. These activities play a crucial role in providing liquidity to financial markets within the European Union and market makers need to take short positions in performing their task. Imposing notification or disclosure formalities and restrictions in respect of short sales performed by market makers could severely inhibit their ability to provide liquidity and have a significant adverse impact on the efficiency of EU financial markets.^[22]

The exemption in article 17 of the Short Selling Regulation (the SSR exemption) allows market makers to build net short positions, without having to notify the relevant competent authorities and disclose to the public, and to enter into short sales without having coverage for them. The SSR exemption applies only to those transactions that are essential in order to perform market-making activities as defined in article 2(1)(k) of the Short Selling Regulation. All other trading activities conducted by a market maker (and, in particular, proprietary trading) are subject in their entirety to the prohibitions and transparency requirements of the Short Selling Regulation.

Market makers wishing to take advantage of the SSR exemption must notify the relevant competent authority, as specified in article 17(5) and (8)^{[23][24]} of the Short Selling Regulation, at least 30 calendar days before they first intend to use that exemption.^[25] The competent authorities can prohibit the use of the exemption at any time, either during the 30 calendar days from when they receive the notification, or subsequently where there have been changes in the circumstances of the notifying person so that it no longer satisfies the conditions of the exemption. This may result from an own assessment by the competent authorities or from a subsequent notification received from the notifying person indicating a change affecting its ability to use the exemption.

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19. See ESMA Decision of 16 Mar. 2020 to require natural or legal persons who have net short positions to temporarily lower the notification thresholds of net short positions in relation to the issued shares capital of companies whose shares are admitted to trading on a regulated market above a certain threshold to notify the competent authorities in accordance with point (a) of Article 28(1) of Regulation (EU) No 236/2012 of the European Parliament and of the Council (ESMA 70-155-9546) , available at https://www.esma.europa.eu/sites/default/files/library/esma70-155-9546_esma_decision_-_article_28_ssr_reporting_threshold.pdf (accessed 8 June 2020). According to art. 2(2) of said decision, "a relevant notification threshold is a percentage that equals 0.1% of the issued share capital of the company concerned and each 0.1% above that threshold". Based on art. 3(2), however, the temporary additional transparency obligations referred to in art. 2 shall not apply to market-making activities. Under art. 4, the decision entered into force immediately upon its publication on ESMA's website and it shall apply from the date of its entry into force for a period of three months.
 20. See ESMA Decision of 10 June 2020 "renewing the temporary requirement to natural or legal persons who have net short positions to temporarily lower the notification thresholds of net short positions in relation to the issued share capital of companies whose shares are admitted to trading on a regulated market to notify the competent authorities above a certain threshold in accordance with point (a) of Article 28(1) of Regulation (EU) No 236/2012 of the European Parliament and of the Council" (ESMA 70-155-10189), available at https://www.esma.europa.eu/sites/default/files/esma70-155-10189_esma_decision_-_renewal_article_28_ssr_reporting_threshold.pdf (accessed 5 July 2020). Based on art. 3(2), the temporary additional transparency obligations shall not apply to transactions performed due to market-making activities. Under art. 4, the decision entered into force on 17 June 2020 and it shall apply from the date of its entry into force for a period of three months.
 21. The Short Selling Regulation provides that parties can only enter into a short sale of a share where certain conditions are met. Before conducting a short sale, the person needs either: (i) to have borrowed the share; (ii) to have entered into an agreement to borrow the share or have another absolutely enforceable claim so that settlement can be effected when due; or (iii) to have an arrangement with a third party which has confirmed the share has been located and has taken measures so that the short seller has a reasonable expectation that settlement can be effected when due.
 22. According to recital 26 Short Selling Regulation:
Market making activities play a crucial role in providing liquidity to markets within the Union and market makers need to take short positions to perform that role. Imposing requirements on such activities could severely inhibit their ability to provide liquidity and have significant adverse impact on the efficiency of the Union markets. Furthermore, market makers would not be expected to take significant short positions except for very brief periods. It is therefore appropriate to exempt natural or legal persons involved in such activities from requirements which could impair their ability to perform such a function and therefore adversely affect the Union markets. In order for such requirements to capture equivalent third-country entities a procedure is necessary to assess the equivalence of third-country markets. The exemption should apply to the different types of market-making activity but not to proprietary trading...
Competent authorities should be notified of the use of exemptions and should have the power to prohibit a natural or legal person from using an exemption if they do not fulfil the relevant criteria in the exemption. Competent authorities should also be able to request information from the natural or legal person to monitor their use of the exemption.
 23. Art. 17(5) reads as follows:
the exemption referred to in paragraph 1 shall apply only where the natural or legal person concerned has notified the competent authority of its home Member State in writing that it intends to make use of the exemption. The notification shall be made not less than 30 calendar days before the natural or legal person first intends to use the exemption. Under art. 17(8), a third-country entity that is not authorized in the Union shall send the notification referred to in paragraphs 5 and 6 to the competent authority of the main trading venue in the Union in which it trades.
 24. A person wishing to use the SSR exemption must notify the competent authority of its home Member State, as defined in art. 2(1)(n) Short Selling Regulation. Third-country entities not authorized in the European Union must notify the competent authority of the main trading venue in the European Union in which they trade. The third-country entity is required to assess its activity in the course of the preceding year on the basis of the turnover (as defined in art. 2(9) MiFID I Implementing Regulation) per trading venue when performing market making activities in Europe and identify on which trading venue (i.e. regulated market or MTF) it is the most active.
 25. The notification procedure is not an authorization or licensing process by the competent authority.

The SSR exemption is also available for market-making activities in third countries, provided that the other conditions are met and that the EU Commission has decided that the legal and supervisory framework of the specific country complies with legally binding requirements equivalent to those laid down by MiFID concerning regulated markets and by the Market Abuse and Transparency Directives.^[26] So far, however, the EU Commission has not adopted any such equivalency decisions.

Paragraphs 19-57 of the ESMA Guidelines address the interpretation of the market-making definition in the Short Selling Regulation. The ESMA Guidelines were published in accordance with article 16(3) of the Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 (the ESMA Regulation),^[27] in order to ensure a level playing field, consistency of market practices and convergence of supervisory practices across the EEA.^[28]

However, the ESMA's narrow interpretation of the market-making exemption in the Short Selling Regulation prevents legitimate market-making activities from taking advantage of the SSR exemption and this has led to a situation in which several Member States do not follow the ESMA Guidelines in full.

Indeed, national competent authorities were required to notify the ESMA within two months from the publication of the guidelines, stating whether they would comply or intend to comply with them or not, with reasons for possible non-compliance. In 2013:

- four disagreeing NCAs (among them BaFin^[29] and the FCA^{[30][31]}) reported that they were not going to comply with certain provisions of the guidelines as they disagreed with the interpretations set out by the ESMA. This is the case in particular for (i) the so-called “membership” requirement, i.e. the requirement that the exemption is granted for market making on financial instruments notified only to the extent that the market maker is a member of the trading venue on which market making is (at

26. Art. 17(2) Short Selling Regulation:

The Commission may, ..., adopt decisions determining that the legal and supervisory framework of a third country ensures that a market authorised in that third country complies with legally binding requirements which are, for the purpose of the application of the exemption set out in paragraph 1, equivalent to the requirements under Title III of Directive 2004/39/EC, under Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) and under Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, and which are subject to effective supervision and enforcement in that third country.

Directive 2004/39/EC (MiFID I) and Directive 2003/6/EC are no longer in force, having been replaced by, respectively, the MiFID II package and by Regulation (EU) No. 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse.

27. Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No. 716/2009/EC and repealing Commission Decision 2009/77/EC.

28. In addition to its guidelines, the ESMA published the following documents concerning the Short Selling Regulation and the SSR exemption:

- the Final Report on ESMA's technical advice on the evaluation of the Short Selling Regulation (the SSR Final Report) – ESMA/2013/614, published on 3 June 2013, available at https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-614_final_report_on_ssr_evaluation.pdf (accessed 8 June 2020);
- the Final Report on the ESMA Guidelines (the Guidelines Final Report) – ESMA/2013/158, published on 1 Feb. 2013, available at <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-158.pdf> (accessed 8 June 2020);
- a compliance table concerning the ESMA Guidelines (the Compliance Table). The Compliance Table was originally published on 19 June 2013 (ESMA/2013/765), available at https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-765_guidelines_compliance_table_-_market_making_guidelines.pdf (accessed 8 June 2020) and was then updated in 2019 when the disapplying NCAs notified ESMA that they would cease to comply with certain provisions of the ESMA Guidelines (ESMA70-21038340-46), available at https://www.esma.europa.eu/sites/default/files/library/esma70-21038340-46_compliance_table_-_guidelines_on_market_making_activities_under_ssr.pdf (accessed 8 June 2020);
- a peer review report concerning the compliance by a group of competent authorities with the Short Selling Regulation as regards market making activities (the Peer Review Report) – ESMA/2015/1791, published on 5 Jan. 2016, available at https://www.esma.europa.eu/sites/default/files/library/2015-1791_peer_review_report_compliance_with_ssr_as_regards_market.pdf (accessed 8 June 2020). The Peer Review was aimed at assessing how national competent authorities apply the SSR exemption and focuses on those markets with the highest number of market makers benefiting from the exemption and the markets in which market makers have notified the highest number of instruments. The Peer Review was limited to the competent authorities of Germany (BaFin), Italy (CONSOB), the United Kingdom (FCA), Sweden (Finansinspektionen (FI)) and Hungary (Magyar Nemzeti Bank). Three of them (BaFin, FCA and FI) had reported in 2013 that they were not going to comply with certain provisions of the ESMA Guidelines, as they disagreed with the interpretation set out by the ESMA. And, indeed, the Peer Review confirms that these authorities do not comply in full with the guidelines;
- a consultation paper on the evaluation of certain elements of the Short Selling Regulation (the Consultation Paper) ESMA70-145-127, published on 7 July 2017, available at https://www.esma.europa.eu/sites/default/files/library/esma70-145-127_consultation_paper_on_the_evaluation_of_certain_aspects_of_the_ssr.pdf (accessed 8 June 2020); and
- the Final Report on ESMA's Technical Advice on the evaluation of certain elements of the Short Selling Regulation (the 2017 Final Report) – ESMA70-145-386, published on 21 December 2017, available at https://www.esma.europa.eu/sites/default/files/library/technical_advice_on_the_evaluation_of_certain_aspects_of_the_ssr.pdf (accessed 8 June 2020). The 2017 Final Report is the follow-up to the Consultation Paper.

29. Bundesanstalt für Finanzdienstleistungsaufsicht (Germany).

30. Financial Conduct Authority (United Kingdom).

31. The other two disagreeing NCA are the *Financial Supervisory Authority* (Denmark) and the *Finansinspektionen* (Sweden).

least, partially) performed;^[32]^[33] and (ii) the “product scope” requirement, which does not allow to exempt instruments other than shares or instruments creating long positions in shares;^[34]^[35]

- the French national competent authority (AMF)^[36] stated that it intended to comply with the full provisions of the ESMA Guidelines, though the said guidelines would only enter into force as soon as they were fully applied by all NCAs throughout the EU agreed;
- all other NCAs (including CONSOB and Bank of Italy) stated that they agreed with the content of the ESMA Guidelines and intended to comply with them.

Between December 2018 and November 2019, the NCAs of Spain (CNMV)^[37], Ireland (Bank of Ireland) and Italy (CONSOB and Bank of Italy) have announced that they would stop to comply with the provisions of the ESMA Guidelines concerning the membership requirement and (except Italy) the product scope requirement, to avoid an unlevel playing field.

The details of the position of the disagreeing NCAs and of the disapplying NCAs are set out in the Compliance Table, as last updated on 3 December 2019.

2.2. The market-making definition in the Short Selling Regulation

Market-making activities are defined in article 2(1)(k) of the Short Selling Regulation as:

the activities of an investment firm, a credit institution, a third-country entity, or a firm as referred to in point (l) of Article 2(1) of Directive 2004/39/EC which is a member of a trading venue or of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission pursuant to Article 17(2) where it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the following capacities:

- (i) by posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;
- (ii) as part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade;
- (iii) by hedging positions arising from the fulfilment of tasks under points (i) and (ii).

The SSR exemption only applies to transactions of a market maker carried out performing the above-mentioned activities (liquidity provision, client facilitation and related hedging) and on the condition that all relevant requirements are satisfied. The exemption does not cover the entire scope of activity of a market maker; in particular, as clearly stated in recital 26 of the Short Selling Regulation, it does not apply to proprietary trading.

Market-making activities eligible for the SSR exemption are only those undertaken by the entities specifically listed in article 2(1)(k) of the Short Selling Regulation: investment firms, credit institutions or third country entities. Any such entity is entitled to avail itself of the SSR exemption, provided that it is a member of a trading venue (or a market in a third country with declared equivalent regime) and it performs as principal, whether on or outside a trading venue, any of the quoting, client servicing and hedging activities listed in article 2(1)(k) in respect of the financial instruments for which it notifies the exemption.^[38]

^{32.} These provisions are not complied with by all Disagreeing NCAs.

^{33.} See sec. 2.3.

^{34.} Differently from the other Disagreeing NCAs, the Danish NCA (Financial Supervisory Authority) is not disagreeing with the ESMA Guidelines provisions dealing with the product scope requirement.

^{35.} See sec. 2.4.

^{36.} *Autorité des marchés financiers* (France).

^{37.} *Comisión Nacional del Mercado de Valores* (Spain).

^{38.} As clarified in para. 19 ESMA Guidelines, to qualify for the exemption, therefore, market-making activities must be undertaken, whether on or outside a trading venue, by the following entities:

- an investment firm which is a member of a trading venue where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in art. 2(1)(k); or
- a credit institution which is a member of a trading venue where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in art. 2(1)(k); or
- a third-country entity which is a member of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission under art. 17(2) where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in art. 2(1)(k); or
- a firm as referred to in point (l) of art. 2(1) MiFID I, which is a member of a trading venue where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in art. 2(1)(k) (these are firms which provide investment services and/or perform investment activities consisting exclusively in dealing on own account on markets in financial futures or options or other derivatives and on cash markets for the

2.3. The membership requirement

2.3.1. General

According to article 2(1)(k) of the Short Selling Regulation, a market maker must be “a member of a trading venue ... where it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the” quoting, client servicing and hedging activities mentioned in the same article 2(1)(k).

The first requirement that needs to be satisfied by a party that wishes to use the SSR exemption is, therefore, that it must be a member of a trading venue, which is either a regulated market within the meaning of point (14) of article 4(1) of MiFID I or a multilateral trading facility within the meaning of point (15) of article 4(1) of MiFID I.^[39]^[40]

2.3.2. The ESMA's narrow interpretation of the membership requirement

The ESMA interprets in a narrow manner the membership requirement in the market-making definition, making it a condition for the exemption that the market maker is a member of a trading venue where the financial instrument in question is admitted to trading or traded and in which it conducts a market-making activity in that instrument. The ESMA Guidelines unduly limit the scope of the exemption by setting out the pre-condition that no firm can qualify for the exemption unless it is a member of a trading venue on which it market makes the instrument for which the exemption is claimed.

In the feedback statement section contained in the Guidelines Final Report,^[41] it is explicitly stated that an entity intending to benefit from the exemption needs to be a member of a trading venue, where it conducts some market-making activities, including hedging, on a specific financial instrument. In addition, it is also confirmed that the concerned instrument must be admitted to trading or traded on that trading venue.^[42] Thus, the SSR exemption would not apply to instruments that are not admitted to trading on a regulated market or traded on a multilateral trading facility (MTF).^[43]

More in detail, according to the ESMA, the Short Selling Regulation requires (i) a market maker to be a member of the trading venue on which it conducts (at least partially) market-making activities in the particular financial instrument(s) identified in the notification to the competent authority and (ii) the instrument(s) included in the notification to the competent authorities to be admitted to trading or traded on that venue of which that person is a member. Based on the ESMA Guidelines,^[44] there are indeed three preconditions for particular activities of an entity to be exempted from the Short Selling Regulation's provisions. That entity (i) must be a member of the market on which it (ii) deals as principal in one of the capacities mentioned in the market-making definition (iii) in the financial instrument for which it notifies the exemption.^[45]^[46]

Even though a market maker is not required to conduct its market-making activities solely on the venue or market of which it is a member,^[47] the narrow interpretation of the membership requirement adopted by the ESMA excludes from the SSR exemption all

sole purpose of hedging positions on derivatives markets or which deal for the accounts of other members of those markets or make prices for them and which are guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such firms is assumed by clearing members of the same markets).

39. See art. 2(1)(l) Short Selling Regulation.

40. Based on art. 2(1)(k) Short Selling Regulation, the SSR exemption is in principle also available to a third-country entity which is a member of a market in a third country, the legal and supervisory framework of which has been declared equivalent by the Commission pursuant to art. 17(2). However, the EU Commission has not published any equivalency declarations yet.

41. ESMA consulted on draft Guidelines in mid-Sept. 2012 (see ESMA/2012/580, available at <https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-580.pdf> (accessed 8 June 2020)). The Guidelines Final Report includes a feedback statement on the most important issues raised during the consultation process.

42. See para. 5 of the feedback statement in the Guidelines Final Report:

ESMA has taken considerable time to closely consider the Regulation and explore through a legal analysis whether there were ways to accommodate non-admitted/non-traded instruments for the purpose of the market making exemption in Article 17(1). Results of the analysis led to a negative conclusion.

43. An MTF is a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract.

44. See para. 20 ESMA Guidelines.

45. The membership requirement is confirmed in various other parts of the ESMA Guidelines and, amongst others, in paras. 35, 36, and 43 which read as follows: 35. Any natural or legal person intending to make use of the exemption for market making activities and notifying the relevant competent authority of its intention should be a member of a trading venue (i.e. a regulated market or a MTF as defined in Article 4(14) and 4(15) of MiFID) or of an “equivalent” market in a third country where it deals as principal in a financial instrument in any of the two capacities and related hedging activities specified in Article 2(1)(k). 36. In either case, the instrument which is the subject of the notification should be admitted to trading or traded on that venue or market of which that person is a member. For financial instruments referred to in paragraph 30 [i.e. financial instruments, other than shares and sovereign debt, that create long or short positions in shares or sovereign debt], it is not required to be a member of the venue where the corresponding share or sovereign debt is admitted to trading or traded. 43. A person ... that intends to use the exemption ... must be a member of a trading venue where the financial instrument in question is admitted to trading or traded and in which it conducts a market making activity on that instrument....

46. In para. 22 ESMA Guidelines, it is also stated that the Commission services have expressed in writing their legal analysis of the market making definition contained in art. 2(1)(k) Short Selling Regulation, which makes clear that the assessment of the membership requirement for the qualification of market-making activities has to be done with respect to each individual financial instrument and that, accordingly, market-making activities on instruments that are not admitted to trading or traded in any trading venue cannot qualify for the SSR exemption as the membership requirement cannot be met.

47. See para. 21 ESMA Guidelines.

market-making activities on instruments that are not admitted to trading or traded on any trading venue (as is the case for many non-listed derivatives) and limits the ability to offer over-the-counter (OTC) market making.

A considerable amount of market-making activities, however, occurs away from trading venues and may relate to financial instruments which are either not traded on any trading venue (“pure OTC instruments”) or admitted to trading or traded on a trading venue (“exchange-traded instruments”). In the latter case, market-making activities can take place either on a trading venue or OTC.

Based on the ESMA Guidelines, the SSR exemption is not available for market-making activities in relation to pure OTC instruments. On the other hand, market making in exchange-traded instruments may be exempted under article 17 of the Short Selling Regulation also where the activity is conducted OTC on condition, however, that some market-making activities take place on the trading venue of which the market maker is a member (i.e. market making cannot take place OTC only).^[48]

The reading of the ESMA Guidelines and of other documents published by the ESMA on the topic, suggests that the membership requirement should also be satisfied in respect of hedging activities (i.e. no hedging in pure OTC instruments).^[49]

It follows from the ESMA's interpretation that market makers are not permitted to hedge their liquidity provisions or client facilitation transactions in shares using OTC derivatives. In addition, a transaction in an OTC derivative, even where it relates to a share admitted to trading on a trading venue, which is entered in response to a client order or request to trade, does not qualify as a market-making activity (as the derivative itself is not an exchange-traded instrument); the hedging of such derivative transaction by entering into a trade in the underlying shares (which are exchange-traded instruments) would also not qualify as market-making (i.e. that transaction would not be hedging a market-making activity falling under limb (i) and (ii) of the definition in article 2(1)(k) of the Short Selling Regulation).

Under the ESMA Guidelines, certain legitimate market-making activities have, therefore, been excluded from the scope of the SSR exemption by virtue of a narrow interpretation of the membership requirement and this has a damaging effect on liquidity and efficiency in the cash equity markets and in markets where market makers rely on these instruments to hedge their risk positions. This is one of the main reasons why the disagreeing NCAs have declared non-compliance with some parts of the guidelines on market-making activities and, in particular, with the membership requirement.^[50]

48. See para. 30 Consultation Paper:

In the case of exchange-traded instruments, market making activities can take place on a trading venue or OTC, as for instance in the activity of fulfilling orders initiated by clients or in response to clients' request to trade under article 2(1)(k)(ii) of the SSR [Short Selling Regulation]. The SSR regime in case of exchange-traded instruments requires that market making activities benefiting from the exemption should in any case take place on the trading venue of which the market maker is a member and, in addition, could also take place OTC, but cannot take place OTC only.

49. See para. 36 ESMA Guidelines, which indicates that the instrument to which the market-making exemption relates must be admitted to trading or traded on a trading venue of which the firm is a member. Where the market making occurs in a financial instrument other than shares (e.g. derivatives), the firm does not have to be a member of the trading venue where the related share is admitted to trading or traded, but it seems clear that the ESMA expects the firm to be a member of the trading venue where the derivative is admitted to trading or traded. In para. 5 Guidelines Final Report, the ESMA confirms that the membership requirement needs to be satisfied for hedging activities as well:

an entity intending to benefit from the exemption needs to be a member of a trading venue, where it conducts some market making activities, including hedging, on a specific financial instrument. In addition, it is also confirmed that the concerned instrument must be admitted to trading or traded on that trading venue. Thus, the exemption cannot apply to instruments that are not admitted to trading on a regulated market or traded on an MTF.

In para. 152 SSR Final Report, the ESMA acknowledges that “market makers in OTC equity derivatives may hedge their risk by taking a short position in the corresponding underlying equity” and states that:

a requirement to obtain the necessary locate and other confirmations every time they conduct a short sale will add extra process and costs to their market making operations ... Under the current Guidelines OTC equity derivative market makers are therefore at a disadvantage to their exchange-traded equity derivative counterparts who would qualify for the market maker exemption under the ESMA Guidelines. Although this is in line with the interpretation of the wording of Article 2(1)(k), it is not clear that this different treatment of market makers in OTC products is justified.

50. The ESMA's interpretation of the membership requirement, which significantly restricts the scope of application of the SSR exemption, seems to be going beyond what is required in the Short Selling Regulation, for the following reasons:

- first, based on Recital (2)6 of the Short Selling Regulation, the broad purpose of the SSR exemption is to enable firms to provide liquidity to the EU “markets”. The Recital uses the broad term “markets” and is not restricted to the provision of liquidity to regulated markets and MTFs. As such, the Recital seems to be suggesting that the provision of liquidity to all markets, whether conducted via trading venues or OTC, is an important function performed by market makers;
- second, although the first limb of article 2(1)(k) of the Short Selling Regulation states that a market maker must be a member of a trading venue or third country equivalent market, it does not say in the second limb that the financial instrument for which the SSR exemption is sought must be traded on that market; and
- third, the ESMA's reading of the membership requirement relies on a specific meaning attributed to the adverb “where” contained in the English text of the market-making definition in the Short Selling Regulation, which is not supported by other equally authentic language versions of the Short Selling Regulation and is in conflict with the meaning that same word has in other places of the same regulation. Indeed, the ESMA has allegedly interpreted that adverb as a geographical reference that establishes a link between the trading venue and the financial instrument(s) (i.e. the membership requirement is considered in relation to the trading venue on which the financial instrument of the exemption is traded). Indeed, as stated in para. 16 Consultation Paper, “... In the ESMA Guidelines it was clarified that membership should be considered in relation to the trading venue on which the financial instrument of the exemption is traded”. Other language versions of the market making definition do not establish any link between the trading venue of which the

The ESMA has acknowledged in various documents^[51] that, in principle, the reasons for granting the SSR exemption apply irrespective of whether the market maker is dealing in a pure OTC instrument or in an exchange-traded instrument and that the difference in treatment between market makers in OTC products and market makers in exchange-traded instruments, although in line with the wording of the Short Selling Regulation (as interpreted by the ESMA), does not seem to be justified. As such, the ESMA has suggested that the requirement for the market maker to be a member of the trading venue where the product in which it is market making is admitted to trading or traded should be reconsidered by the legislator (i.e. that the definition of market-making activities in the Short Selling Regulation should be revisited).

2.4. The product scope requirement

Under the ESMA Guidelines, equity market-making activities may only be carried out in relation to shares and financial instruments that create long or short positions in shares as defined in article 3 of the Short Selling Regulations.^[52] These are “those listed financial instruments the position of which must be taken into account when calculating the net short positions”, as listed in Part 1 of Annex I of the Commission Delegated Regulation (EU) No. 918/2012: options, covered warrants, futures, index-related instruments, contracts for difference, shares/units of ETF, swaps, spread bets, packaged retail or professional investment products, complex derivatives, certificates linked to shares, and global depository receipts.

The ESMA Guidelines seem to be unduly restricting the scope of products that are eligible for the SSR exemption and this has again the effect of excluding legitimate market-making activities from the exemption (e.g. market-making activities in convertible bonds and subscription rights may not be eligible for the SSR exemption). Indeed, article 2(1)(k) of the Short Selling Regulation defines “market-making activities” as those activities where the person deals as principal in a financial instrument (whether traded on or outside a trading venue) and article 2(1)(a) of the Short Selling Regulation contains a straightforward definition of “financial instrument”, referring to the instruments listed in section C of Annex I of MiFID I.^[53] There seems to be no reason to depart from that definition for the purposes of the SSR exemption, which should therefore be eligible in respect of any MiFID financial instrument. The ESMA restricts the instruments eligible for the SSR exemption to those instruments that are listed in part 1 (and part 2, as far as sovereign debt is concerned) of Annex 1 of Commission Delegated Regulation (EU) No. 918/2012. However, those lists are made for different and specific purposes (i.e. to catalogue the instruments that must be taken into account when calculating a net short position in shares or sovereign debt) and are not deemed to set out a general limitation on the types of financial instruments which may benefit from the SSR exemption.

2.5 The stances adopted by the NCAs in relation to the ESMA Guidelines

2.5.1 The Italian NCAs initial full compliance with the ESMA Guidelines

On 5 June 2013, Bank of Italy and CONSOB^[54] published a joint communication, stating their intention to comply in full with the ESMA Guidelines.^[55]

Differently from the disagreeing NCAs, CONSOB and Bank of Italy clearly make reference, in their joint communication, to paragraph 20 of the ESMA Guidelines, where it is stated that an entity can benefit from the SSR exemption, provided that it is a member of the market on which it deals as principal in one of the relevant capacities (liquidity provision, client facilitation and related hedging) in the financial instrument for which it notifies the exemption.

relevant party is a member and the financial instrument in which it deals and for which it claims the SSR exemption. These other language versions clearly state that the requirement for membership of a trading venue and the requirement to deal as principal in the financial instruments are two separate and unconnected tests (in French, the term “et” (meaning “and”) is used; in German, the term “wenn” (meaning “when”) is used; in Spanish, the term “si” (meaning “if”) is used; in Italian, the term “quando” (meaning “when”) is used; in Polish, the wording “w przypadku gdy” (meaning “in the case where”) is used). The word “where” in the English version should therefore be interpreted as “in the circumstances in which” or “when/if”. That is indeed the meaning the word clearly has in other places of the Short Selling Regulation (see , for instance, Recitals (15) and (21) and arts. 2(1)(b), 2(1)(e), 3(1)(b) and 4(1)) and there is nothing to indicate that a different meaning of “where” is intended in art. 2(1)(k). Accordingly, the preconditions for the SSR exemption to apply should be that (i) the relevant party is a member of a trading venue; and (ii) it deals as principal in the relevant financial instrument. It should be irrelevant whether the instrument is dealt on that venue (or any other venue) or not.

51. See para. 152 Short Selling Regulation Final Report and para. 26 Consultation Paper.

52. Paras. 30 and 32 ESMA Guidelines.

53. Reference should now be made to sec. C Annex I MiFID II.

54. Art. 4-ter (2) Legislative Decree 24 February 1998, n. 58 (the Italian Finance Code) designates CONSOB as the national competent authority for receiving the notifications, implementing the measures and exercising the functions and powers provided for in the Short Selling Regulation in relation to shares and financial instruments other than sovereign debt and sovereign credit default swaps. Para. 3 of the same article designates Bank of Italy and CONSOB as the competent authorities for exercising the ordinary functions and powers provided for in the Short Selling Regulation in relation to sovereign debt and sovereign credit default swaps.

55. See Bank of Italy/CONSOB joint communication concerning the transposition of the Guidelines issued by AESFEM (ESMA), concerning the exemption for market-making activities and primary market operations under Regulation (EU) No. 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swap, available at <https://www.bancaditalia.it/compiti/sispaga-mercati/short-selling/normativa/2013-06-Comunicazione-congiunta-BI-Consob.pdf> (the document is available in Italian only) (accessed 8 June 2020). The communication highlights some of the main issues in the ESMA Guidelines and provides operational guidance on the procedure to be followed for their application in Italy.

The clarifications contained in the joint communication are consistent with the ESMA Guidelines. Indeed, CONSOB and Bank of Italy plainly state, quoting paragraphs 20 and 43 of the ESMA Guidelines, that the market-making activity must be conducted at least in part in a trading venue of which the market maker is a member and where the financial instrument for which the SSR exemption is sought is traded or admitted to trading. As indicated in paragraph 21 of the ESMA Guidelines, the Italian regulators also clarify that not all of the market-making activity must be conducted on that trading venue or market. Last but not least, it is also stated that the instrument pertaining to the market-making activity must be admitted for trading in the venue or market and that, accordingly, as indicated in paragraph 22 of the ESMA Guidelines, market-making activities related to financial instruments that are not admitted for trading on any trading venue or market cannot benefit from the SSR exemption.

Strangely enough, the Italian text of the Short Selling Regulation is not consistent with the narrow interpretation of the “membership requirement” adopted by the ESMA, which relies on the “locational” meaning attributed to the adverb “where” contained in the market-making definition. Indeed, the Italian text states that market making means the activity of a person that “is a member of a trading venue ... when it deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the”^[56] quoting, client servicing and hedging activities mentioned in article 2(1)(K) of the Short Selling Regulation. However, even though the Italian version of the Short Selling Regulation would not support the ESMA’s narrow interpretation, the Italian regulators have decided to comply in full with the ESMA Guidelines and, in particular, with the membership requirement as interpreted therein.

2.5.2. The disagreeing NCA’s stated non-compliance with the ESMA Guidelines

All disagreeing NCAs stated in 2013 that they would comply with the ESMA Guidelines with the exception of the provisions concerning the requirement for the market maker to be a member of the trading venue where the relevant financial instrument is traded^[57] and the scope of the products eligible for the SSR exemption.

In particular, BaFin and the FCA^[58]^[59] only require a notifying entity to be a member of a trading venue in the European Union. They do not require, as the ESMA Guidelines request,^[60] that membership must be of the trading venue where the instruments are listed and where market making is performed. As noted by the ESMA in the Peer Review Report, “the extent of the non-compliance with” the membership requirement, as interpreted in the ESMA Guidelines, “is mainly limited to market making activities in OTC financial instruments, for which the criterion could not be met by definition”.^[61]^[62] On the other hand, “for listed financial instruments, such as shares traded in Regulated Markets or MTFs, the trading venue membership is met in the vast majority of cases in Germany, Sweden and the UK”.^[63]

BaFin and the FCA also declared disagreement and non-compliance with the “product scope” of the ESMA Guidelines,^[64] arguing that the SSR exemption should be available in respect of market-making activities on all MiFID financial instruments (as suggested in the first draft of the ESMA Guidelines), while the Guidelines limit the exemption to shares and instruments that must be taken into account when calculating a net short position in shares.

In the Peer Review Report, the ESMA emphasizes the point about the different technical approaches amongst the reviewed regulators (e.g. on the membership requirement or on the scope of instruments eligible for the SSR exemption) and encourages the EU Commission to look at this in its forthcoming review of the Short Selling Regulation.

2.5.3 The approach adopted by the disapplying NCAs

The French NCA (AMF) is a disapplying NCA since 2013. The AMF is not actually challenging any interpretations set out by ESMA in its guidelines. Indeed, as indicated in the Compliance Table:

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56. The Italian text reads as follows:
«attività di supporto agli scambi (market making)», le attività di un’impresa di investimento, di un ente creditizio, di un soggetto di un paese terzo o un’impresa di cui all’articolo 2, paragrafo 1, lettera l), della direttiva 2004/39/CE, che sia membro di una sede di negoziazione o di un mercato di un paese terzo il cui quadro giuridico e di vigilanza sia stato dichiarato equivalente dalla Commissione ai sensi dell’articolo 17, paragrafo 2, quando agisce in qualità di operatore principale per uno strumento finanziario negoziato in una sede di negoziazione o fuori di essa...
57. Paras. 19-22; 35-36; 43 (first indent only and last indent, to the extent that it relates to those parts of the ESMA Guidelines that are not complied with) ESMA Guidelines.
58. These are the disagreeing NCAs that provided the more detailed explanations of their non-compliance with the membership requirement.
59. The Swedish NCA (*Finansinspektionen* , FI) and the Danish NCA (*Financial Supervisory Authority*) are also not compliant with the membership requirement as interpreted by ESMA.
60. Paras. 20-22 ESMA Guidelines.
61. Para. 63 Peer Review Report.
62. Indeed, BaFin, the FCA and FI also permit the SSR exemption for market making on pure OTC derivatives (i.e. entities that have notified the intention to carry out market making activities in these instruments will not be objected to by those NCAs), while CONSOB (until the end of October 2019) and the MNB (the Hungarian NCA) do not permit such notifications, as compliance with the ESMA Guidelines, and the strict membership requirement stated therein means that SSR exempted market making on pure OTC derivatives is not possible. This divergence is a consequence of the different interpretations of the definition of market-making activities in the Short Selling Regulation.
63. See para. 63 Peer Review Report.
64. Paras 30, 32, 65 (xi), and 75 ESMA Guidelines.

the AMF declared to ESMA that it intends to comply with the full provisions of the guidelines though the said guidelines shall only enter into force as soon as they are fully applied by all National Competent Authorities throughout the EU. This is in order to avoid competition distortion between the French financial industry and that of any EU Member States partially or not applying the Guidelines. Hence, a common level playing field based on converging supervisory and market practices across the EU shall be achieved, as mentioned in paragraph 10 of the guidelines.

In 2018, the Spanish NCA (CNMV) became the second disapplying NCA, notifying ESMA that it would cease to comply with the Membership Requirement and the Product Scope Requirement. Indeed, on 26 December 2018, the CNMV published a statement (the CNMV statement)^[65] in relation to the ESMA Guidelines, announcing that it had decided to cease to apply these guidelines exclusively to those aspects requiring market-making activities to be confined to instruments admitted to trading on a trading venue. Consequently, entities that wish to use the SSR exemption may also apply for exemption without restriction in relation to financial instruments not admitted on a trading venue, provided that they notify CNMV accordingly.

The reasons for this non-compliance are the lack of an EEA harmonized application of the ESMA Guidelines and the delayed reform of the Short Selling Regulation. Indeed, the CNMV points out the following in its public statement:

- the CNMV had adopted the ESMA Guidelines in 2013 “on the basis that they would allow the process for notification of the use of the exemption for market making activities to be harmonized at European level by providing a harmonized notification model and establishing a harmonized system for assessment of the conditions for applying for the exemption”;
- the NCAs of Germany, the United Kingdom, Sweden and Denmark decided in 2013 not to adopt some of the points of the ESMA Guidelines, since the SSR exemption could not be extended to market-making activity for instruments only traded *OTC*; the French NCA announced that, in order to avoid distortion of competition affecting its markets and/or industry, it had also decided not to apply the guidelines until there was convergence in this respect at European level;
- in December 2017, ESMA published the 2017 Final Report, containing its technical advice to the European Commission on the assessment of certain elements of the SSR, following the European Commission’s announcement that it would review the legal text. This advice analysed the SSR exemption and the definition of “market-making activities”. ESMA proposed not imposing the requirement to be a member of a trading venue in order to also apply the exemption to *OTC* market-making activities. However, the proposed reform of the Short Selling Regulation, for which ESMA’s advice was requested, has not yet been presented by the European Commission and, given the legislative timetable of the European Parliament, its processing and adoption may be significantly delayed.

Even though the CNMV statement only addresses the membership requirement, it appears from the updated Compliance Table published by ESMA that the CNMV has decided not to comply with the product scope requirement as well.^[66]

In 2019, the Irish NCA (CBOI)^[67] became the third disapplying NCA, notifying ESMA that it would cease to comply with the membership requirement and the product scope requirement. Indeed, on 6 June 2019, the CBOI published an article on its website^[68] in relation to the ESMA Guidelines. In more detail:

- according to the CBOI, the purpose of the ESMA Guidelines is to ensure a level playing field, consistency of market practices and convergence of supervisory practices across the EEA. These objectives are fully supported by the CBOI;^[69]
- however, the CBOI believes that the level playing field is significantly undermined by the fact that a significant number of NCAs do not apply the ESMA Guidelines in full. To the extent the ESMA Guidelines are not applied, they are not effective, and their implementation has become problematic;

65. The CNMV statement is available at <https://www.cnmv.es/portal/verDoc.axd?t=%7Ba529395b-f1f2-4d14-a211-d23bd41c0c0c%7D> (accessed 8 June 2020).

66. Indeed, in the section of the Compliance Table dedicated to Spain the following is stated:

- the CNMV declared in 2019 that the purpose of the Guidelines was to ensure a level playing field, consistency of market practices and convergence of supervisory practices across the EEA. However, after more than five years from their implementation, the fact that there is not a full compliance by some key jurisdictions causes an unlevelled playing field. In addition, in December 2017 ESMA submitted to the Commission its technical advice on the revision of the Short Selling Regulation. In relation to the exemption for the market making activities, the technical advice recommends that for *OTC* market making no market membership should be required. However, the fact that such a proposal, if it comes, will take an additional period of time creates a situation that could severely damage the activity of the Spanish market makers in favour of market makers from those Member States not complying with the Guidelines;
- therefore, the CNMV has decided to still apply the Guidelines with the exemption of the following: trading venue membership requirement (paragraphs 19-22; 35-36; 43 first bullet and last bullet); and product scope (paragraphs 30; 32).

67. Central Bank of Ireland.

68. The article is available at <https://www.centralbank.ie/regulation/markets-update/article/markets-update-issue-5-2019/central-bank-of-ireland/esma-guidelines-on-the-exemption-for-market-makers-under-the-short-selling-regulation> (accessed 8 June 2020).

69. In 2013, the CBOI notified ESMA that it would comply with the ESMA Guidelines in full.

- as consequence, until the lack of convergence is remedied, the CBOI will comply with the ESMA Guidelines save for the provisions that are not applied by other NCAs, “specifically relating to requirements to be a member, in all cases, of a trading venue where the market making is carried out” (membership requirements)^[70] and the scope of products in which market making can be carried out in order to avail of the exemption” (product scope requirement)^[71].

As indicated in the Compliance Table, it is, however, the CBOI’s intention to fully comply with the ESMA Guidelines when they are effective, i.e. when all NCAs have notified their full compliance with them.

On 4 November 2019, the Italian NCAs (CONSOB and Bank of Italy) joined the group of disapplying NCAs, notifying ESMA that they would cease to comply with the membership requirement.^[72] In more detail:

- as pointed out by CONSOB and Bank of Italy in their new joint communication, the interpretation of the Short Selling Regulation adopted in the ESMA Guidelines (specifically, the trading venue membership requirement), “prevents entities which carry out market making activities entirely outside a trading venue from benefitting from the exemption”;
- the ESMA Guidelines have been applied in Italy since June 2013, as indicated in the joint communication of 5 June 2013. However, seven years after the entry into force of the SSR, “there is still no harmonization across Europe with regard to the exemption for market making activities, as national competent authorities of the main countries of the Union do not entirely comply with the ESMA Guidelines. In particular, the national competent authorities of the United Kingdom, Germany, France and, recently, Spain, allow the use of the exemption for market making activities which do not comply with the abovementioned trading venue membership requirement”. Moreover, as it has resulted from the peer review carried out by ESMA in 2015, “a few national competent authorities that formally declared their compliance with the Guidelines have adopted a supervisory approach which partly differs from the Guidelines”;
- CONSOB and Bank of Italy also note that ESMA, in its technical advice of 21 December 2017, suggested to the Commission that the Short Selling Regulation should be amended “to clarify that market makers should not be required to comply with the trading venue membership requirement in order to benefit from the exemption. Nonetheless, the process for amending the Regulation has yet to begin and, consequently, its completion will take quite time”;
- as a consequence of the above, “taking into account the fact that the ESMA Guidelines are currently applied, in their entirety, in only a minority of Member States, and considering the position taken by ESMA in its technical advice, and having regard to the fact that the application of the Guidelines by the Italian competent authorities exposes Italian entities to an unlevel playing field compared with other European entities”, CONSOB and Bank of Italy have decided to cease to apply the provisions of the ESMA Guidelines dealing with the membership requirement;^[73]
- market makers subject the supervision of CONSOB and Bank of Italy will, therefore, “be able to benefit from the exemption for market making activities in shares, sovereign bonds and financial instruments linked to shares and sovereign bonds, even when such market making activities are carried out entirely outside a trading venue”. This clearly expands the scope of market-making activities which can benefit from the SSR exemption. Indeed, “to give an example, market making activities in financial instruments traded over-the-counter only, like sovereign credit default swaps and equity contracts for difference, will be able to benefit from the exemption”.

CONSOB and Bank of Italy have in essence followed the same approach already adopted by the other disapplying NCAs (AMF, CBOI and CNVM). Indeed, all these NCAs are not disagreeing with the narrow interpretation adopted by ESMA in the guidelines. Nonetheless, they have decided not to apply the parts of the ESMA Guidelines dealing with the membership requirement (and, except Italy, the product scope requirement) to avoid an unlevel playing field.

2.6. The 2017 Final Report

2.6.1. Introduction

The ESMA received a formal mandate from the Commission on 19 January 2017 seeking technical advice on the evaluation of certain elements of the Short Selling Regulation, including aspects of the market-maker exemption.^[74] This advice by the ESMA

^{70.} Paras 19-22, 35- 36, and 43 first bullet and last bullet ESMA Guidelines.

^{71.} Paras. 30 and 32 ESMA Guidelines.

^{72.} See the CONSOB and Bank of Italy joint communication published on 4 November 2019, available at https://www.bancaditalia.it/compiti/sispaga-mercati/short-selling/normativa/Update-Joint-Bdl-Consob.pdf?language_id=1 (accessed 8 June 2020).

^{73.} The areas where CONSOB and Bank of Italy intend not to comply with the ESMA Guidelines are paras. 19-22; 35-36 and 43 first and last bullet.

^{74.} Based on the Commission formal request for Technical Advice:

ESMA is asked to analyse whether the exemption for market making activities and the definition of market making activities is adequately clear, in view of current practices and as evidenced in previous reviews undertaken by ESMA in relation to its guidelines on that topic, whether the scope of such exemption is appropriate in view of its objective to safeguard the positive role of market making activities with respect to market liquidity and efficiency, and whether the notification procedure of Article 17(5) is adequate, effective and efficient. In particular, ESMA is asked to assess the impact of the membership

should contribute to the follow-up actions announced by the Commission in its Communication on the Call for Evidence on the EU regulatory framework for financial services published on 23 November 2016.

On 7 July 2017, the ESMA published the Consultation Paper regarding its future technical advice to the Commission,^[75] seeking the views of market participants on three specific topics: (i) the exemption for market-making activities under article 17 of the Short Selling Regulation; (ii) the short-term restrictions on short selling in case of a significant decline in prices based on article 23 of the Short Selling Regulation; and (iii) the transparency of net short positions and reporting requirements. Responses to the Consultation Paper were requested to be submitted to the ESMA by 4 September 2017.

With specific reference to market making and the SSR exemption, the ESMA was asked by the European Commission to analyse the following elements:

- whether the exemption for market-making activities and the definition of “market-making activities” is adequately clear, in view of current practices;
- whether the scope of such exemption is appropriate in view of its objective to safeguard the positive role of market-making activities with respect to market liquidity and efficiency; and
- whether the notification procedure of article 17(5) is adequate, effective and efficient.

In particular, the ESMA was asked to assess the impact of the membership requirement featured in the definition of article 2(1)(k) on those entities making markets on financial instruments which are only traded OTC, and to assess the consequences, if any, of the absence of alignment between the definition of “market-making activities” in article 2(1)(k) of the Short Selling Regulation and that of “market maker” in article 4(1)(7) of MiFID II.

In carrying out its analysis of the issues covered by the mandate, the ESMA was encouraged to seek the views of competent authorities and market participants.

The ESMA published the outcome of its consultation and its advice to the Commission on 21 December 2017.^[76]

2.6.2. The ESMA's advice in relation to market-making activities carried out OTC

The ESMA reiterates the assessment made in its 2013 Technical Advice on the evaluation of the Short Selling Regulation. Indeed, according to the ESMA:

- the arguments for an exemption for OTC market makers remain valid, given that the entities carrying out those activities need to take short positions and conduct short sales in order to fulfil their role;
- any significant short positions that market makers enter into in the course of their activity should not be directional bets on the price of a financial instruments and should be maintained for very brief periods while they square their book.

Consequently, the ESMA considers that investment firms or credit institutions authorized to perform OTC market-making activity by dealing on their own account should be able to benefit from the exemption.

The ESMA also considers that the definition currently contained in the second limb of article 2(1)(k) of the Short Selling Regulation should be specified through technical standards with the requirements presently contained in the ESMA Guidelines, and in particular, clarifying that the activity is undertaken as part of the firm's regular business as described in paragraph 54 of the ESMA Guidelines. Therefore, either the firm already deals on a frequent and systematic basis in the financial instrument in question or, if the instrument is traded on an ad-hoc and infrequent basis, the firm stands ready and prepared to provide prices to clients at all times (i.e. during business hours).

The ESMA proposes expanding the scope in terms of instruments also to “pure” OTC instruments. From that perspective, market-making activity should also encompass the activity of an investment firm that enters into a bilateral OTC financial instrument in response to a client's request to trade, as long as the above-mentioned requirements are met.

2.6.3. The ESMA's advice in relation to the product scope requirement and hedging activities

The ESMA reiterates its 2013 Technical Advice on the evaluation of the Short Selling Regulation.

requirement featured in the definition of Article 2(1)(k) on those entities making markets on financial instruments which are only traded OTC, and to assess the consequences, if any, of the absence of alignment between the definition of “market making activities” in Article 2(1)(k) of the Regulation and that of “market maker” in Article 4(1)(7) of Directive 2014/65/EU.

⁷⁵ The Consultation Paper is available at <https://www.esma.europa.eu/document/consultation-paper-evaluation-short-selling-regulation> (accessed 8 June 2020).

⁷⁶ See 2017 Final Report – ESMA70-145-386, available at https://www.esma.europa.eu/sites/default/files/library/technical_advice_on_the_evaluation_of_certain_aspects_of_the_ssr.pdf (accessed 8 June 2020).

According to the ESMA, with respect to shares, the instruments benefitting from the SSR exemption should be the ones included in Part 1 of Annex I of Commission Delegated Regulation (EU) 918/2012 (i.e. options, covered warrants, futures, index-related instruments, CFDs, shares/units of ETFs, swaps, spread bets, packaged retail or professional investment products, complex derivatives, certificates linked to shares, global depository receipts), plus subscription rights and convertible bonds.

The ESMA recommends that for those instruments to be included in the scope of the exemption they should have the relevant share as underlying.

As a result of the ESMA's proposal to include subscription rights and convertible bonds, the list of instruments within the scope of the SSR exemption would differ from the list of instruments that may create a net short position in an instrument included in Annex I, Parts 1 and 2 of Commission Delegated Regulation (EU) 918/2012. Accordingly, ESMA recommends amending the Short Selling Regulation to permit the introduction of a different list of instruments that may benefit from the SSR exemption through a revision of Commission Delegated Regulation (EU) 918/2012.

The ESMA also reiterates that activities in the corresponding share will be exempted only to the extent that they are undertaken for the purpose of hedging market-making activities (e.g. posting two-way quotes or fulfilling orders initiated by the clients) in the above-mentioned instruments. There should be a direct link between the market-making activity in any of the instruments described above and the short position in the corresponding share.

The ESMA recalls the points made in its Technical Advice on the evaluation of the Short Selling Regulation back in 2013 regarding the application of the SSR exemption to OTC instruments. Consequently, the scope in terms of instruments described above should be applicable regardless of whether the instrument is traded on a trading venue (as defined in MiFID II) or is only traded OTC, as long as the market-making activity (hedging) involves a share admitted to trading in an EU regulated market or MTF. From that perspective, the ESMA considers that the definition in the second limb of article 2(1)(k) of the Short Selling Regulation should be further specified through technical standards with the following requirements:

- the OTC financial instrument has to be within the expanded list proposed by ESMA in its Technical Advice and have the relevant share as underlying; and
- there has to be a strict link between the market-making activity as described above and the hedging activity undertaken on a trading venue or OTC.

2.6.4. The ESMA's advice in relation to the membership requirement with respect to on-exchange market-making activity on instruments admitted to trading on a trading venue

The ESMA is of the view that the definition currently contained in article 2(1)(k) of the Short Selling Regulation should be revised in order to require the market maker to be member of one of the trading venues where the market-making activity effectively takes place.

The ESMA also believes that firms benefitting from the market-making exemption on the basis of their market-making activity on a trading venue should always meet the following requirements:

- market makers should be dealing strictly on their own account (this requirement should be applicable in equal terms for firms operating OTC);
- minimum requirements in terms of presence, size and spread should be met by the firms benefitting from the SSR exemption. ESMA recommends those requirements, some of which are currently laid down in ESMA Guidelines, should be set through technical standards for specific types of instruments.

2.6.5. The ESMA's advice in relation to the membership requirement with respect to OTC market-making activity for instruments only traded OTC

The ESMA proposes not requiring the membership requirement with respect to the market-making activity on instruments not traded in any EU trading venue.

This also implies that investment firms/credit institutions authorized to deal on their own account could hedge their OTC market-making activity on a trading venue, without having to be a member/participant (or client) of that venue.

2.6.6. The ESMA's advice in relation to the membership requirement with respect to OTC market-making activity on instruments traded on-venue

The ESMA proposes that firms undertaking OTC market-making activities regarding instruments traded in an EU trading venue should be able to benefit from the exemption without being required to be members/participants of those venues.

This also implies that investment firms/credit institutions authorized to deal on their own account could hedge their OTC market-making activity on a trading venue, without having to be a member/participant (or client) of that venue.

The ESMA underlines that firms benefitting from the SSR exemption due to their OTC market-making activity will remain subject to the requirements set out in articles 23 (obligation to trade shares on a regulated market, MTF or systematic internalizer) and 28 (obligation to trade classes of derivatives subject to the trading obligation on a regulated market, MTF or OTF^[77]) of MiFIR as long as they hedge their activity using shares or derivatives subject to the trading obligation.

Firms simultaneously undertaking a market-making activity on-venue and OTC should be able to benefit from the exemption as long as they fulfil the membership requirement for the on-venue market-making activity.

3. The IFTT Rules

3.1. The IFTT exemption for market makers in light of the divergences between competent authorities

Based on article 16(3)(a), first paragraph, of the Treasury Decree, transactions in chargeable equities and chargeable derivatives executed in the exercise of market-making activities, as defined in article 2(1)(k) of the Short Selling Regulation and in the ESMA Guidelines, are exempt from IFTT.^[78]

Until the end of October 2019, it was generally believed that the analysis of the disagreeing NCAs' approach to the ESMA Guidelines was probably largely moot in relation to the IFTT MM exemption, since the Italian tax authorities would follow the guidance on the scope of market-making activity contained in the ESMA Guidelines. Indeed, article 16(3)(a) of the Treasury Decree, as mentioned above, does not contain any independent tax definition of "market making" and specifically references for these purposes the Short Selling Regulation and the ESMA Guidelines. In addition, unlike other NCAs, the Italian NCAs (CONSOB and Bank of Italy) had notified ESMA in 2013 that they intended to comply with the Guidelines^[79] and they were indeed complying with them. Last but not least, the Italian tax authorities have informally stated that reference will be made to the ESMA Guidelines for the purposes of the IFTT MM exemption.^[80]

3.2. The IFTT implications of the November 2019 CONSOB/Bank of Italy joint communication

Starting from 4 November 2019, however, CONSOB is no longer requiring market makers to comply with the membership requirement, as narrowly interpreted by ESMA.^[81] In this respect, two approaches could be adopted.

Based on the wording of the Treasury Decree, that still makes reference to the ESMA Guidelines (which have not been amended), one possible interpretation is that the recent CONSOB/Bank of Italy is only relevant for the SSR exemption and that, for the purposes of the IFTT MM exemption, market makers are still required to comply with all the provisions of the ESMA Guidelines, including those dealing with the membership requirement. In this respect, the following should be noted:

- this approach renders, for Italian market makers as well, the scope of the IFTT MM exemption narrower than that of the SSR exemption. This is precisely the scenario that UK and German market makers have faced so far, since their NCAs (the FCA and BaFIN) disagree with the interpretation adopted by ESMA and are not applying the provisions of the ESMA Guideline dealing with the membership requirement (and the product scope requirement);
- the literal interpretation of the Treasury Decree would continue to leave open the possibility that the disagreeing NCAs/disapplying NCAs could accept that the SSR exemption is available to a market maker and a financial instrument in circumstances in which the IFTT MM exemption is not available to that market maker in respect of that financial instrument. Indeed, the IFTT exemption would be available in circumstances where a market maker is a member of a trading venue where

77. An organized trading facility (OTF) is a multilateral system, which is not a regulated market or MTF and in which multiple third-party buying and selling interests in bonds, structured finance product, emissions allowances or derivatives are able to interact in the system in a way which results in a contract.

78. According to art. 16(4) Treasury Decree, the IFTT MM exemption is only granted to market makers and limited to the transactions executed in the exercise of market making activities. Art 16(4) seems somehow equivalent to para. 13 ESMA Guidelines, where it is stated that "the exemption applies only to the transactions carried out in performance of market making activities as defined above [...]; it does not apply to the entire scope of activity of the notifying entity. As recital 26 [of the Short Selling Regulation] clearly states, such an exemption does not cover the proprietary trading of those persons". Accordingly, the purpose of art. 16(4) quoted should be to make it clear that the IFTT MM exemption (i) only applies to transactions that are genuinely executed in the capacity of market making; and (ii) does not apply to the entire scope of activity of the market maker (and, in particular, it does not cover proprietary trading of that person).

79. See sec. 2.5.1.

80. References to the ESMA Guidelines are contained in an unofficial draft Q&A on the scope of the IFTT MM exemption, which however has never been finalized and published by the Italian authorities.

81. See sec. 2.53.

the underlying financial instruments (shares or derivatives) are admitted to trading or traded and conducts therein market-making activities on those financial instruments (these market-making activities on those financial instruments may also be carried out in other trading venues or *OTC*). On the contrary, the IFTT MM exemption would not be available when a market maker trades or hedges pure *OTC* financial instruments (i.e. financial instruments that are not admitted to trading or traded in any trading venue);

- this approach would not expose market makers to any liabilities vis-à-vis the Italian tax authorities (even though clients may complain, arguing that the IFTT should not have been charged). Market makers could also file IFTT refund claims, which would, however, most likely be explicitly or implicitly rejected by the Italian tax authorities (thus the need to start a litigation in front of the tax courts).

Based on a more substance-over-form approach, however, it seems illogical to follow the ESMA Guidelines (*rectius*, the parts of the ESMA Guidelines dealing with the membership requirement) in a scenario whereby CONSOB is disapplying them for the purposes of the SSR exemption. In this respect, the following should be noted:

- the substance-over-form approach above would generate a significant reduction of IFTT payments by market makers. The IFTT return for 2020 (to be filed within the end of March 2021) would show a significant increase of market-making exempted trades (to be reported in section III) and a corresponding decline in taxable trades and tax payments (to be reported in section I);
- the Italian tax authorities could react to the reduction of IFTT payments and the figures reported in the next IFTT returns by sending a questionnaire (as they did in the past), asking for clarifications, and/or starting a tax audit.

A possible route to be followed for getting clarity on the matter is to file a ruling application with the Italian tax authorities. The upside is that the response would provide clarity (thus avoiding any further discussions with clients). The downside is that the tax authorities may take a restrictive approach, confirming the compliance with the membership requirement as per the ESMA Guidelines.

4. Brexit's Impact on the Availability of the IFTT MM Exemption for UK-Based Market Makers

On 29 March 2017, the United Kingdom, following the outcome of a referendum, notified the European Council of its intention to withdraw from the European Union, pursuant to article 50 of the Treaty on European Union (TEU).^[82]

According to article 50(3) of the TEU, the United Kingdom was due to leave the European Union as from 30 March 2019, 00:00 (CET), unless the European Council, in agreement with the United Kingdom, unanimously decided to extend this period.

At the United Kingdom's request, the European Council agreed to three extensions of the period provided for in article 50(3) of the TEU.

Given the increasing likelihood that the United Kingdom could have left the European Union without a ratified Withdrawal Agreement in place (no-deal Brexit) several Member States (including Italy) have enacted their own no-deal preparedness legislation to address the uncertainties and difficulties of a no-deal Brexit and mitigate the cliff-edge implications for the banking and financial industry (and a range of other sectors).

On 17 October 2019, the European and the United Kingdom reached a final agreement on the Withdrawal Agreement, establishing the terms of the United Kingdom's departure and providing for a transition period (also known as an "implementation period") during which EU law would continue to apply to and in the United Kingdom as if it were a Member State. On the same day, the European Council (article 50) endorsed these texts.^[83]

The United Kingdom left the European Union on 31 January 2020 (the exit day) with a ratified Withdrawal Agreement^[84] in place:

- until the exit day, the United Kingdom has remained a Member State with full rights and obligations in accordance with article 50 of the TEU;
- the United Kingdom became a third country on 1 February 2020;

^{82.} Treaty on European Union (TEU).

^{83.} In Jan. 2020, the UK House of Commons and the European Parliament approved the Withdrawal Agreement. On 31 Jan. 2020, the Council of the European Union concluded the Withdrawal Agreement.

^{84.} The final text of the Withdrawal Agreement is available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1580206007232&uri=CELEX%3A12019W/TXT%2802%29> (accessed 8 June 2020).

- EU law will, however, continue to apply to and in the United Kingdom during the transition period, as provided for by Part IV of the Withdrawal Agreement, so that the United Kingdom's and EU-27's⁸⁵ access to one another's markets will continue on current terms throughout the transition period.

Consequently, the Italian emergency measures adopted in the event of a no-deal Brexit⁸⁶ did not enter into force.

The Short Selling Regulation continues to apply to the United Kingdom throughout the transition period.

As a consequence, until 31 December 2020:

- all short-selling notifications made to the FCA should remain valid;
- the IFTT MM exemption should remain available to UK firms, on the same terms that currently apply.

5. CONSOB's Short Selling Prohibition

5.1. Introduction

According to article 23(1) of the Short Selling Regulation:

where the price of a financial instrument on a trading venue has fallen significantly during a single trading day in relation to the closing price on that venue on the previous trading day, the competent authority of the home Member State for that venue shall consider whether it is appropriate to prohibit or restrict natural or legal persons from engaging in short selling of the financial instrument on that trading venue or otherwise limit transactions in that financial instrument on that trading venue in order to prevent a disorderly decline in the price of the financial instrument. Where the competent authority is satisfied under the first subparagraph that it is appropriate to do so, it shall in the case of a share or a debt instrument, prohibit or restrict natural and legal persons from entering into a short sale on that trading venue or in the case of another type of financial instrument, limit transactions in that financial instrument on that trading venue in order to prevent a disorderly decline in the price of the financial instrument.

Article 20 of the Short Selling Regulation allows an NCA to introduce restrictions on short selling and similar transactions in exceptional circumstances. In more detail:

- under article 20(1), an NCA may take one or more of the measures referred to in paragraph 2 of the article where (i) there are adverse events or developments which constitute a serious threat to financial stability or to market confidence in the Member State concerned or in one or more other Member States; and (ii) the measure is necessary to address the threat and will not have a detrimental effect on the efficiency of financial markets which is disproportionate to its benefits; and
- under article 20(2), an NCA may prohibit or impose conditions relating to natural or legal persons entering into (i) a short sale; or (ii) a transaction other than a short sale which creates, or relates to, a financial instrument and the effect or one of the effects of that transaction is to confer a financial advantage on the natural or legal person in the event of a decrease in the price or value of another financial instrument.

Based on article 24(1) of the Short Selling Regulation, a measure imposed under article 20 shall be valid for an initial period not exceeding 3 months from the date of publication of the notice referred to in article 25. This latter provision requires an NCA to publish on its website notice of any decision to impose or renew any measure referred to in article 20.

Pursuant to article 26 of the Short Selling Regulation, before imposing or renewing any measure under article 20, NCAs shall notify ESMA and the other competent authorities of the measure they propose. The notification shall include details of the proposed measures, the classes of financial instruments and transactions to which they will apply, the evidence supporting the reasons for those measures and when the measures are intended to take effect.

In accordance with article 27(2) of the Short Selling Regulation, the ESMA shall within 24 hours of the notification made by a competent authority under article 26 of that same regulation, issue an opinion on whether it considers the measure or proposed measure is necessary to address the exceptional circumstances.

⁸⁵. The reference to the EU-27 should be read as also including Iceland, Liechtenstein and Norway, which are members of the European Economic Area.

⁸⁶. IT: Law Decree No. 22, 25 Mar. 2019, converted into law by IT: Law No. 41, 20 May 2019 (so-called Brexit Decree).

Against the above background, on 17 March 2020, CONSOB adopted a resolution^[87] under article 20 of the Short Selling Regulation, making use of its powers of intervention in exceptional circumstances and introducing an emergency measure based on article 20(2)(a) and (b).^[88] In more detail:

- the measure adopted by CONSOB banned any legal or natural person from entering into transactions which might constitute or increase net short positions on all shares traded on the Italian MTA regulated market, for which CONSOB is the relevant competent authority under MIFID II and the Short Selling Regulation (the restricted shares) as well as to all related instruments relevant for the calculation of the net short position as determined in Annex I, part 1, articles 5 and 6 of Commission Delegated Regulation (EU) 918/2012. The ban applied to transactions executed both on a trading venue or over the counter;
- the measure applied to any natural or legal person domiciled or established within the European Union or in a third country;
- the measure did not apply to index-related instruments if the restricted shares represented less than 20% of the index weight;^[89]
- based on article 20(3) of the Short Selling Regulation, the measure did not apply to market-making activities, as defined in articles 2(1)(k) and 17 of the same regulation, with reference to market makers included on the list maintained by ESMA;
- the creation of, or increase in, net short positions when the investor who acquires a convertible bond has a delta-neutral position between the equity component of the convertible bond and the short position taken to cover that component, did not fall within the scope of the measure. Similarly, the measure did not apply to the creation of, or increase in, net short positions where the creation of, or increase in, the short position in shares is hedged by a purchase that is equivalent in terms of proportion on subscription right;
- the measure entered into force on 18 March 2020 before the opening of the trading session and expired after the close of the trading session on 18 June 2020.

As required by article 26 of the Short Selling Regulation, CONSOB notified ESMA of its intention to introduce an emergency measure under article 20(2)(a) and (b) of the Short Selling Regulation.^[90]

On 17 March 2020, the ESMA issued an official opinion agreeing to the above emergency short selling prohibition adopted by CONSOB.^[91] Indeed, ESMA considered that the proposed measure was justified by the adverse events or developments which constituted a serious threat to market confidence and financial stability in Italy and that it was appropriate and proportionate to address the existing threat to market confidence in the Italian market.

5.2. Impact of the short selling restriction on the availability of the IFTT MM exemption

The three-month short selling restriction adopted by CONSOB by means of Resolution 21303 of 17 March 2020 specifically excluded from its scope of application market-making activities, as defined in articles 2(1)(k) and 17 of the Short Selling Regulation, with reference to market makers included on the list maintained by ESMA.

As a consequence, the short selling restriction should have no adverse impact on the availability of the IFTT MM exemption.

87. CONSOB, *Temporary prohibition of taking and increasing net short positions in shares traded in the MTA Italian regulated market, pursuant to Article 20 of the Regulation (EU) of the European Parliament and of the Council no. 236 of 14 March 2012*, available at <http://www.consob.it/web/consob-and-its-activities/other-regulatory-measures/documenti/english/resolutions/res21303.htm> (accessed 8 June 2020).

88. By way of resolution 21302 of 16 Mar., CONSOB adopted a temporary prohibition of short selling in some shares traded in the MTA, according to art. 23 of the Short Selling Regulation. That prohibition was in force on 17 Mar. 2020 and has not been renewed.

89. In other words, the ban applied to index-related instruments only if the restricted shares represent 20% or more of the index weight.

90. CONSOB considered that the measure was justified by the existence of specific adverse circumstances that constituted a serious threat to market confidence in Italy, especially regarding the confidence of a fair price determination. Namely, following the outbreak of the COVID-19 pandemic in Italy, the Italian financial market had started a strong downside price movement with a high price volatility. CONSOB noted that in the same period a relevant increase in trading volumes took place, thus the fall of the FTSE MIB value was not caused nor intensified by a lack of liquidity on the market. Namely, from 6 Mar. until 12 Mar. 2020, CONSOB observed an increase of around 22.35% in net short positions reported to CONSOB in Italian shares in respect to FTSE MIB market capitalization (from 1.19% of 6 Mar. 2020 to 1.46% of 12 Mar. 2020). CONSOB also noted that the 22.35% increase represented only part of the overall increase in net short positions, as net short positions as a result of market making activities are not reported, and, as at the date of the notification, that was also the case for net short positions below the threshold of 0.2% of the issued share capital. Thus, CONSOB believed that the overall increase of net short positions in Italian shares was greater than 22.35%. According to CONSOB, the proposed ban on net short positions should have minimized the risk of a loss of market confidence in the Italian financial market.

91. See *Opinion of the European Securities and Markets Authority of 17 March 2020 on a proposed emergency measure by the Commissione Nazionale per le Società e la Borsa under Section 1 of Chapter V of Regulation (EU) No 236/2012* (ESMA 70-155-9565), available at https://www.esma.europa.eu/sites/default/files/library/esma70-155-9565_opinion_on_consob_emergency_measure_under_the_ssr_all_shares.pdf.